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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

No. 555

R. H. OSWALD COMPANY, INC., *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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No.

R. H. OSWALD COMPANY, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI.

To the Honorable The Chief Justice and The Associate Justices of the Supreme Court of the United States:

Your petitioner, R. H. Oswald Company, Inc., respectfully submits its petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, which judgment affirmed the decision of the Tax Court of the United States in the above-entitled case. (R. 114, 129.)

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on November 10, 1950. (R. 114.) Petition for rehearing was filed on November 24, 1950 (R. 115), and

denied by the Court below on December 15, 1950. (R. 129.) The jurisdiction of this Honorable Court is invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, Title 28, Chapter 81, § 1254, U. S. Code.

STATEMENT OF THE CASE.

This action involves the federal income and excess profits tax liability of petitioner for the fiscal years ended June 30, 1943 and June 30, 1944. (R. 3.)

The question in the Tax Court was whether the compensation of $45,767.83 and $48,503.12 paid by petitioner to Oswald, its president and general manager, for performing all of the executive and management services for petitioner during said respective years was reasonable compensation, within the meaning of Section 23(a), I. R. C. (R. 3, 7.)

The Commissioner of Internal Revenue allowed only $9,600.00 for each year. (R. 9.) The Tax Court determined that a reasonable allowance was $22,500.00 for 1943 and $25,000.00 for 1944. (R. 82.) The Court of Appeals below affirmed the Tax Court. (R. 114, 129.)

Petitioner was organized in 1922 by Oswald and Sparrenberger to conduct the wholesale fruit and vegetable business in Evansville, Indiana. Prior thereto, Oswald had had 11 years experience in that kind of business in Evansville. He has been petitioner's president and general manager ever since its organization; and since 1938, when he bought Sparrenberger's stock, Oswald has performed all of petitioner's executive and management services. (R. 20-22, 25, 28, 29, 35, 41, 42, 78, 79.)

During 1943 and 1944, Oswald devoted 6 days and 5 nights a week to petitioner's business, spending from 15 to 16 hours during each 5-day-and-night period and about 10 hours during the sixth day, and sometimes more. (R. 29-36.)

In 1930, petitioner's Board of Directors placed petitioner's salesmen on a commission basis as an incentive to them; and for the same reason petitioner's Board on Janu-

ary 8, 1930 passed a resolution fixing the compensation of Oswald and Sparrenberger, its two executive officers, at a salary of $7,200.00 each and total additional compensation to both equal to 50% of petitioner's earnings remaining after petitioner earned 20% on its capital stock. (R. 11, 13, 39.)

This resolution was in effect until August 6, 1941, when petitioner's Board passed a new resolution fixing Oswald's salary at $7,200.00 and his additional compensation in an amount equal to petitioner's earnings remaining after petitioner earned 80% on its capital stock, the additional compensation not to be effective, however, until petitioner's net worth exceeded $75,000.00. Similar resolutions were in effect during petitioner's fiscal years 1943 and 1944, except the salary was changed to $9,600.00 due to the increase in the cost of living. The compensation paid to Oswald during these fiscal years was for performing all of petitioner's executive and management services, although customarily four executives are required for such services; and the compensation paid Oswald represented the total compensation paid by petitioner for executive and management services. During some of the depression years in the 1930's, petitioner did not draw his entire salary of $7,200.00. (R. 11, 13-15, 38-41, 64.)

Petitioner's net sales, net income, and amounts paid to Oswald and Sparrenberger from 1922 to 1938, inclusive, and to Oswald from 1939 to 1946, inclusive, and deducted on petitioner's income tax returns as officers' compensation for said respective years, were as follows:

Taxable Year	Net Sales	Net Income	Oswald	Sparrenberger	Total
1923	$ 356,354.38	$11,423.21	$ 2,700.00	$ 2,700.00	$ 5,400.00
1924	566,442.32	19,718.13	3,600.00	3,600.00	7,200.00
1925	589,301.61	17,212.14	4,500.00	4,500.00	9,000.00
1926	830,708.88	31,593.10	5,200.00	5,200.00	10,400.00
1927	834,759.99	32,070.46	6,000.00	6,000.00	12,000.00
1928	1,004,471.18	33,138.88	6,000.00	6,000.00	12,000.00
1929	996,997.08	24,851.15	7,200.00	7,200.00	14,400.00
1930	1,111,010.13	12,809.52	10,604.81	10,604.81	21,209.62
1931	1,106,296.44	10,764.75	9,582.38	9,582.38	19,164.76
1932	750,063.50	417.22	6,600.00	6,600.00	13,200.00
1933	483,600.99	(10,105.01)	6,000.00	6,000.00	12,000.00
1934	635,134.69	3,019.06	5,000.00	5,000.00	10,000.00
1935	535,616.54	(5,708.60)	5,000.00	5,000.00	10,000.00
1936	786,924.03	8,790.61	8,595.31	8,595.30	17,190.61
1937	365,406.51	2,640.72	7,200.00	7,200.00	14,400.00
1938	731,720.17	3,860.61	7,200.00	2,216.67	9,416.67
1939	745,010.57	(733.01)	7,200.00	.....	7,200.00
1940	809,626.90	5,394.74	7,200.00	.....	7,200.00
1941	864,234.37	5,837.06	7,200.00	.....	7,200.00
1942	1,150,225.23	17,256.36	7,200.00	.....	7,200.00
1943	1,884,758.83	24,000.00	45,767.83	.....	45,767.83
1944	2,350,855.23	24,000.00	48,503.12	.....	48,503.12
1945	2,602,082.88	24,000.00	48,519.64	.....	48,519.64
1946	2,434,831.67	24,000.00	21,706.43	.....	21,706.43

(R. 11.)

The only testimony in the Tax Court on the value of Oswald's services was that of petitioner's witness, Abramson (R. 55-73), who testified that he was secretary of the Produce Reporting Company, a credit reporting agency of the wholesale fruit and vegetable business; that he had been connected with the Produce Reporting Company for 32 years; that his company published an annual Blue Book which gave financial and other ratings of about 150,000 fruit and produce businesses; that as secretary of his company it has been his duty and responsibility to collect the necessary data from the respective wholesale fruit and vegetable businesses and also to compile the information which went into the annual Blue Book. (R. 55, 56.)

Abramson further testified that in connection with his work he had called upon various concerns and talked with them about their operations; that he had met and talked with various fruit and vegetable men in their trade conventions; that they had called at his office and talked about their affairs with him; that from this experience and the information he received from the various concerns to be

used in the Blue Book he had learned what compensation is paid to executives and general managers of the wholesale fruit and vegetable business. (R. 62, 69-71.)

Abramson further testified that he was familiar with petitioner's business and that he had known Oswald for 20 years; and that in his opinion the value of Oswald's services for performing all of petitioner's executive and management services for 1943 was not less than $50,000.00 and for 1944 was not less than $60,000.00 to $65,000.00. (R. 65-69.)

He also testified that according to the information which he obtained in connection with his work, the amount paid to executives and management officers in the wholesale fruit and vegetable business averaged 2½% to 3% of sales for the fiscal years 1943 and 1944. Upon motion of counsel for respondent, this latter testimony only was stricken out by The Tax Court on the ground that it was hearsay. (R. 11, 69-71.)

The Tax Court rejected the testimony of petitioner's witness, Abramson, as to the value of Oswald's services, which was the sole testimony on that subject, and substituted its own judgment as to the value of such services, although there is nothing in the record to show that The Tax Court Judge, who decided the case had any independent personal knowledge, experience or judgment regarding the wholesale fruit and vegetable business in general, petitioner's business in particular, or the amount of compensation customarily paid for services of executive and management officers in the wholesale fruit and vegetable business, which would justify him in substituting his own judgment for the only testimony in the case. Petitioner's petition for a rehearing and review by the entire Tax Court was denied. (R. 83, 97, 98.)

The Court of Appeals below held that The Tax Court could reject the testimony of petitioner's witness, Abramson,

> "even though there is no other evidence on the subject" (R. 111);

and the Court of Appeals affirmed the Tax Court in its determination, although the Court of Appeals expressly held:

> "We find no evidentiary basis for an allowance of these particular amounts." (R. 113.)

QUESTION PRESENTED.

1. Whether the Court of Appeals below erred in holding that the Tax Court, in determining the amount of reasonable compensation under Sec. 23(a), Internal Revenue Code, may reject the opinion of an expert witness as to the value of services rendered by an officer to his corporation, and substitute the Tax Court's own judgment as to the value of such services under the following circumstances:

(a) Where the testimony of the expert witness is the only evidence before the Tax Court as to the value of such services; and

(b) Where there is no evidence that the Tax Court itself has any independent personal knowledge, experience or judgment regarding the subject matter; and

(c) Where the Court of Appeals itself expressly holds that there is no evidentiary basis in the record for the determination made by the Tax Court.

REASONS FOR GRANTING THE WRIT.

I.

The Court of Appeals below has rendered a decision in direct conflict with the decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits on the same subject. (Supreme Court Rule 38, No. 5(b).)

In the following cases, it was held that the Tax Court* may not reject the testimony of an expert witness, and arbi-

* These cases involve the Board of Tax Appeals, the name of which has been changed to The Tax Court of the United States.

trarily reach a conclusion of its own, where there is no other testimony on the subject, and where the Tax Court itself does not have any independent knowledge, experience or judgment of its own regarding the subject matter:

In *Pittsburgh Hotels Co.* v. *Com.* (Third Circuit), 43 Fed. (2d) 345, 347, involving the useful life of hotel property for depreciation purposes; *Boggs & Buhl, Inc.* v. *Com.* (Third Circuit), 34 Fed. (2d) 859, 860, 861, involving the valuation of good will; *Nachod & U. S. Signal Co.* v. *Com.* (Sixth Circuit), 74 Fed. (2d) 164, 167, involving the valuation of patents; *Capitol Barge Dry Cleaning Co.* v. *Com.* (Sixth Circuit), 131 Fed. (2d) 712, 715, involving the valuation of officers' services; *Planters' Operating Co.* v. *Com.* (Eighth Circuit), 55 Fed. (2d) 583, 585, involving the valuation of a hotel lease; *Belridge Oil Co.* v. *Com.* (Ninth Circuit), 85 Fed. (2d) 762, 768, involving the valuation of an option to purchase oil lands; and *Emerald Oil Co.* v. *Com.* (Tenth Circuit), 72 Fed. (2d) 681, 683, involving the valuation of oil lands.

II.

The Court of Appeals has decided an important question of federal law, which has not been, but should be, settled by this court. (Supreme Court Rule 38 5(b).)

Whether the Tax Court may disregard the testimony of an expert witness, where there is no other evidence on the subject, and reach an arbitrary conclusion of its own without any showing that the Tax Court has any independent knowledge, experience or judgment of its own regarding the subject matter,—is an important question of federal law which this Court has not decided, but should decide, for the purpose of uniformity of decisions of Courts of Appeals in cases involving petitions for review of decisions of the Tax Court.

PRAYER.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding that Court to certify and to send to this Honorable Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 10,177, *R. H. Oswald Company, Inc., Petitioner* v. *Commissioner of Internal Revenue, Respondent;* and that the said judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

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BRIEF IN SUPPORT OF PETITION.

Opinion Below.

The opinion of the court below (R. 108) is reported in 185 Fed. (2d) 6.

Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

Question Presented.

The question presented is set forth in the petition on page 6 above.

Statutes Involved.

The statutes involved are set forth in an Appendix attached to the brief.

Statement of the Case.

A statement of the case is made in the petition, beginning on page 2.

Specification of Error to be Urged.

The Court of Appeals erred in holding that the Tax Court could reject the testimony of petitioner's expert witness regarding the value of Oswald's services and reach a conclusion of its own as to the value of such services, where the testimony of petitioner's expert witness was the only testimony on the subject, and where there was no evidentiary basis for the Tax Court's conclusion, and no evidence that the Tax Court itself had any independent knowledge, experience or judgment of its own regarding the subject matter.

ARGUMENT.

I.

The Decision of the Court of Appeals Below is in Direct Conflict With the Decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits on the Same Subject.

Petitioner's expert witness testified that the value of Oswald's services for 1943 was not less than $50,000.00 and for 1944 not less than $60,000.00 to $65,000.00 (R. 66-69.) There was no other evidence whatever as to the value of such services. The Tax Court concluded that a reasonable allowance for Oswald's services for 1943 was $22,500.00 and for 1944 was $25,000.00. (R. 82.) There was no evidence whatsoever in the record from which The Tax Court could have found that Oswald's services were worth $22,500.00 for 1943 and $25,000.00 for 1944, *and The Court of Appeals so held.* (R. 113.)

Nor is there any evidence in the record which indicates that Judge Arnold, who decided the case in The Tax Court, had any independent knowledge, experience or judgment regarding the wholesale fruit and vegetable business or the compensation customarily paid to general managers and executives in such businesses; and The Tax Court refused to review Judge Arnold's decision. (R. 83.)

Notwithstanding there was no evidence as to the value of Oswald's services, except that of petitioner's expert witness; notwithstanding there was no evidence in the record that Judge Arnold or The Tax Court, had any independent knowledge, experience or judgement regarding the subject matters; and notwithstanding the Court of Appeals held that

> "We can find no evidentiary basis for an allowance of these particular amounts"

determined by The Tax Court (R. 113); nevertheless the Court of Appeals held that The Tax Court could reject

the testimony of petitioner's expert witness and substitute The Tax Court's own judgment which had no evidentiary basis. (R. 111.)

The decision of the Court of Appeals for the Seventh Circuit is contrary to the decisions of the Courts of Appeals for at least five other circuits.

In *Pittsburgh Hotels Co.* v. *Com.*, 43 Fed. (2d) 345, 347, the Third Circuit reversed the Board of Tax Appeals for refusing to accept the testimony of the petitioner's expert witnesses relative to the useful life of a hotel building for depreciation purposes, holding:

> "The Board as a general principle of law may reject expert testimony and reach a conclusion in accordance with its own knowledge, experience, and judgment, *but it must itself have knowledge of the subject-matter and experience with it.* There is no evidence whatever that the Board has any independent knowledge of the William Penn Hotel or the particular facts which in this case and locality produce depreciation. *It could not, therefore, arbitrarily disregard all the affirmative and positive testimony applicable to depreciation in this particular case.*" (Italics ours.)

The Third Circuit also held the same way in *Boggs & Buhl, Inc.* v. *Com.*, 34 Fed. (2d) 859, 860, 861, where the expert witnesses had testified as to the value of good will.

In *Nachod & U. S. Signal Co.* v. *Com.*, 74 Fed. (2d) 164, 167, the Board of Tax Appeals had disregarded the testimony of the taxpayer's expert witnesses relative to the valuation of patents for the purpose of exhaustion. The Sixth Circuit reversed the Board, holding:

> "It is true that such testimony, though often helpful, is not binding upon the Board to the extent that it is obliged to follow it if contrary to the judgment of its members. Nevertheless in every case the question must remain whether the value fixed by the Board is arbitrary and unsupported by substantial evidence, or represents a judicial determination reasonably founded upon evidence before it. Grand Rapids Store Equip-

> ment Corp. v. Commissioner, 59 F. (2d) 915 (C. C. A. 6). While the Board as a general principle of law may reject expert testimony and reach a conclusion in accordance with its own knowledge, experience, and judgment, *it must itself have knowledge of the subject-matter and experience with it.* Pittsburgh Hotels Co. v. Commissioner of Internal Revenue, 43 F. (2d) 345 (C. C. A. 3). It cannot arbitrarily disregard all affirmative and positive testimony applicable to value in a particular case." (Italics ours.)

The Sixth Circuit also held the same way in *Capitol-Barg Dry Cleaning Co.* v. *Com.*, 131 Fed. (2d) 712, 715, where the expert witnesses had testified as to the value of services.

In *Planters' Operating Co.* v. *Com.*, 55 Fed. (2d) 583, 585, the Board of Tax Appeals had disregarded the testimony of petitioner's expert witnesses as to value of a hotel lease. The Eighth Circuit held that it was well established:

> "That it is reversible error for the Board of Tax Appeals to disregard competent relevant testimony, when it is not contradicted."
>
> • • •
>
> "We think the testimony of these witnesses, who were qualified and experienced, should have been accorded weight, especially as the record does not disclose that the Board of Tax Appeals had any personal knowledge or experience on which to base a conclusion."

In *Belridge Oil Co.* v. *Com.*, 85 Fed. (2d) 762, 768, the Board of Tax Appeals had disregarded the testimony of petitioner's expert witnesses as to the value of an option to purchase oil lands. The Ninth Circuit reversed, holding:

> "While the Board may reject expert testimony and reach a different conclusion, to justify it in doing so, as pointed out by the authorities, it must itself have knowledge of the subject matter. There is no evidence whatever in this record to indicate that the Board itself has any independent knowledge of the particular facts in the case."

In *Emerald Oil Co.* v. *Com.*, 72 Fed. (2d) 681, 683, a case involving the testimony of expert witnesses as to the valuation of oil properties, the Board of Tax Appeals was affirmed, but in doing so the Tenth Circuit held:

> "The opinion of an expert as to value is not binding on the Board. A fact-finding body may disregard the opinion of an expert and use its own judgment as to value. * * * It may not reject opinion evidence and make an arbitrary finding of value based upon mere conjecture and unsupported by any substantial evidence. But the Board did not do that."

Mertons in his *Law of Federal Income Taxation*, Sec. 59.04, page 10 of Vol. 10A, says:

> "Expert testimony as to valuation of property cannot be disregarded by the Tax Court where there is no other evidence and that tribunal has no knowledge of its own in regard to the valuation of the property,"

citing a number of cases.

Petitioner submits that the decision of the Court of Appeals below is in direct conflict with the foregoing decisions of the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits.

II.

The Court of Appeals Below Has Decided an Important Question of Federal Law Which Has Not Been, But Should be Decided by This Court.

Whether The Tax Court may reject the testimony of an expert witness, which is the only evidence on the subject, and reach a conclusion of its own, which has no evidentiary basis in record, and where there is no indication in the record that The Tax Court itself has any independent knowledge, experience or judgment of its own regarding the subject matter,—is an important question of federal law which affects a large multitude of taxpayers throughout the United States.

The Court of Appeals below cited the opinion of this Court in *Dayton P. & L. Co.* v. *Public Utilities Com.*, 292 U. S. 290, 299, for the general rule that it is not error of law for a trial court or board to refuse to accept opinion testimony where there is other evidence. In that case there was other evidence from which the Commission could have determined the value of the properties in question, and there was no issue raised as to the Commission's right to substitute its own jugment without any evidentiary basis, for the testimony of expert witnesses, whose testimony was the only evidence in the case regarding the subject matter. This Court's decision in that case, therefore, is inapplicable to the question raised in the instant case.

Although the Courts of Appeals for the Third, Sixth, Eighth, Ninth and Tenth Circuits have overruled the Tax Court, the Tax Court persists in substituting its own arbitrary conclusion for the testimony of expert witnesses, without any evidentiary basis for its own conclusion, or any showing that it has any independent knowledge, experience or judgment of its own regarding the subject matter.

This Court has never decided the question, and petitioner submits that it should do so for the guidance of the Tax Court and the Courts of Appeals for the various circuits.

CONCLUSION.

It is respectfully submitted that the decision of the Court below is erroneous, and that the foregoing petition for a writ of certiorari should be granted.

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APPENDIX.

Statutes.

INTERNAL REVENUE CODE.

Sec. 23. Deductions from gross income.

In computing net income there shall be allowed as deductions:

Sec. 23(a) Expenses.

Sec. 23(a)(1) Trade or business expenses.

Sec. 23(a)(1)(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered. . . .